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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

LEON S. SEGEN, derivatively on behalf of APPLIED MICRO CIRCUITS CORPORATION, INC., Plaintiff, v. DAVID M. RICKEY, WILLIAM E. BENDUSH, and APPLIED MICRO CIRCUITS CORPORATION, Defendants.	CASE NO. C 07-2917 MJJ **REPLY IN SUPPORT OF MOTION TO DISMISS COMPLAINT FOR VIOLATION OF THE SECURITIES EXCHANGE ACT OF 1934 BY DEFENDANT WILLIAM E. BENDUSH** Date: December 11, 2007 Time: 9:30 a.m. Dept.: 11 Judge: Hon. Martin J. Jenkins

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MISCELLANEOUS

I. INTRODUCTION

As detailed in Mr. Bendush's opening brief, Plaintiff's theory of Section 16(b) liability is grounded in fraud, yet the Complaint fails to meet the heightened requirements of the Federal Rule of Civil Procedure 9(b). Furthermore, Mr. Bendush is exempt from Section 16(b) liability because the challenged grants are: (1) board-approved transactions under Rule 16b-3(d)(1), and, in two of three grants, (2) options were held at least six months under Rule 16b-3(d)(3).

As detailed below, Plaintiff's Opposition does not refute that his underlying legal theories have already been rejected by courts including the Ninth Circuit and this Court. *See, e.g., Dreiling v. American Express Co.*, 458 F.3d 942 (9th Cir. 2006) and *Olagues v. Semel*, 2007 WL 2188105 (N.D. Cal. Jan. 18, 2007). Plaintiff makes no attempt to identify particularized factual allegations in his Complaint that support his speculation that the three challenged grants to Mr. Bendush were backdated and that the Board failed to approve those grants. Finally, Plaintiff cannot rescue a challenge to grants made over six years ago from a straightforward two-year limitations period with his unsupported and flawed tolling theory. Accordingly, Mr. Bendush requests that the Court dismiss Plaintiff's fatally flawed claims without leave to amend.

II. PLAINTIFF'S OPPOSITION DOES NOT REFUTE THAT PLAINTIFF FAILS TO STATE A SECTION 16(B) CLAIM WITH REQUISITE PARTICULARITY

Plaintiff's theory of liability hinges on a purported fraudulent scheme of backdating and alleged misrepresentations in SEC filings by AMCC and its management. (Compl. ¶¶ 15, 17, 18-22.) While Plaintiff concedes that "Rule 9(b) requires that allegations relating to fraud or breach of duty be pled with specificity," he argues that the Rule simply does not apply to a Section 16(b) claim. (Pl's. Opp'n Br. at 7, 8.) However, <u>none</u> of the cases that Plaintiff relies upon support his proposition as not one concerns a theory of liability based on fraudulent conduct.

Typical Section 16(b) claims do not rely on allegations of fraud and, thus, Rule 9(b) does not apply. However, where a Section 16(b) claim turns on allegations of fraud, Rule 9(b) applies as it would to any such claim. Judge Breyer correctly applied that common sense logic in an action concerning nearly identical allegations of backdating, holding "where the Plaintiff's theory of liability hinges on alleged misrepresentations by the insiders in their Section 16(a)

disclosures," as Plaintiff's theory does here, "the more rigorous standard of Rule 9 applies." *Roth v. Reyes*, 2007 WL 518621 at *8 (N.D. Cal. Feb. 13, 2007) ("*Roth I*").

Rather than meeting his obligation to detail the "the who, what, when, where and how" of the alleged backdating and lack of approval of the challenged options, Plaintiff impermissibly sets forth overly generalized, vague and conflicting claims.[1] *Vess v. Ciba-Geigy Corp.*, 317 F.3d 1097, 1106 (9th Cir. 2003). Indeed, by offering legal conclusions without the underlying factual support, Plaintiff fails to comply with the baseline pleading requirements of Rule 8(a) and Rule 12(b)(6). Because Plaintiff only proffers conclusions, his allegations need not be accepted as true and, thus, dismissal is warranted under Rule 12(b)(6). *Navarro v. Block*, 250 F.3d 729, 731-32 (9th Cir. 2001); *Bureerong v. Uvawas,* 922 F.Supp. 1450, 1462 (C.D.Cal. 1996). Plaintiff's Complaint also fails to contain "enough facts to raise a reasonable expectation that discovery will" support his underlying theory and it is not based on provable, plausible grounds. *Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955, 1965 (2007). Simply stated, Plaintiff's reliance on blanket allegations and unsupported legal conclusions does not pass muster.

III. PLAINTIFF'S OPPOSITION DOES NOT REFUTE MR. BENDUSH'S SHOWING THAT THE BOARD APPROVAL EXEMPTION UNDER RULE 16B-3(D)(1) APPLIES

A. Plaintiff Does Not Refute That The Board Approval Exemption Of Rule 16b-3(b)(1) Applies Where The Board Approved The Grants

Plaintiff does not dispute that the option grants to Mr. Bendush would be exempt under SEC Rule 16b-3(d)(1) if they were approved by AMCC's Board or the Compensation Committee. 17 C.F.R. § 240.16(b)-3(d)(1). Still, Plaintiff does not refute that AMCC's Board or the Compensation Committee approved the grants, as stated in AMCC's Form 10-K on which Plaintiff's Opposition relies. (*See, e.g.,* Form 10-K dated March 31, 2006 at 46-47, attached to Bish Decl. at Ex. A (making repeated references to the Compensation Committee's approval of re-measured options).) Rather, Plaintiff contends it is enough that he alleged that the approval

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[1] Plaintiff's opposition cannot explain his conflicting allegations, such as his simultaneous claim that AMCC's directors "were engaged in a scheme to backdate" the challenged grants and that scheme was "*unknown* to the Board." (Compare Compl. ¶¶ 17 and 21 (emphasis added).)

was not "proper" because some unidentified grants in the time period were not approved in advance. (Pl's. Opp'n Br. at 11.)

There is no language in Section 16(b) or the SEC Rules indicating that the Board must approve a transaction "in advance."[2] Rather, Plaintiff cites to SEC adopting releases in support of his "in advance" requirement, even though the Ninth Circuit dismissed adopting releases as "unexplained dicta"[3] and rejected attempts to create any requirement to the exemption that "conflicts with the plain text" of the Rule. *Dreiling v. American Express Co.*, 458 F.3d 942, 953 (9th Cir. 2006); *see also Roth v. Perseus, LLC*, 2006 WL 2129331 at *11 (S.D.N.Y. July 31, 2006) (rejecting attempt to add requirements to Rule 16b-3(d)). When Plaintiff's counsel asserted the same allegation in *Roth v. Reyes*, Judge Breyer there found that, "[a]n allegation that the board did not properly approve the grants is a legal conclusion, rather than a factual allegation that the board never gave its blessing to the backdated transactions." *Roth I* at *8. As in *Roth v. Reyes*, the lack of factual allegations here is fatal to Plaintiff's claim. *Id.*

B. <u>Plaintiff Fails To Allege With Particularity That The Board Or Compensation Committee Did Not Approve The Challenged Grants</u>

Even if Section 16(b) somehow required board approval in advance, Plaintiff offers no facts—let alone with particularity to satisfy Rule 9(b)—that corroborate that Mr. Bendush received any of the three challenged grants before the Board or Compensation Committee approved them. Instead, Plaintiff tries to support his claim with sweeping quotes from two pages worth of excerpts from AMCC's Form 10-K. (Pl's. Opp'n Br. at 4, citing Form 10-K at 1-3.) But none of those quotes (which often describe an approval process that was in place), identify any particular grants, any individuals involved, or even that the grants at issue were not actually approved before they were received. Simply put, Plaintiff's bald assertion that "[n]one of the

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[2] Rule 16b-3(d)(1) states that a transaction is exempt if it is "approved by the board of directors of the issuer, or a committee of the board of directors that is composed solely of two or more Non-Employee Directors." 17 C.F.R. § 240.16b-3(d)(1).

[3] *Roth v. Reyes*, 2007 WL 2470122 at *6 (N.D. Cal. Aug. 27, 2007) ("*Roth II*") (holding it "implausible that unexplained *dicta* in the SEC's adopting releases would somehow implicitly proscribe the granting of backdated stock options").

Options Grants at issue in this case were approved in advance by the Board or an authorized committee of the Board" is unsupported by facts. (Compl. ¶ 14; Pl.s' Opp'n Br. at 6.) The Complaint never offers facts demonstrating that (1) his backdating allegations are tied to specific grants and Mr. Bendush, and (2) that the Board of Directors actually failed to approve the challenged options. Therefore, as in *Roth*, "Plaintiff has failed to satisfy the heightened pleading requirements applicable to his claim." *Roth I* at *8.

C. Plaintiff Cannot Avoid The Rule 16b-3(d)(1) Exemption By Attempting To Place The Burden Of Substantiating His Allegations On Defendants

Whether Plaintiff's Complaint must stand on Plaintiff's allegations or not at all. Plaintiff attempts to shirk his pleading burden on Defendants with the unexceptional mantra that any missing facts are "within defendants' possession and unknown to plaintiff." (Pl's. Opp'n Br. at 2.) At the same time, Plaintiff makes the contradictory assertion that the Form 10-K in his possession contains "sufficient factual allegations" to support his claims. (Pl's. Opp'n Br. at 2.)

Plaintiff's counsel argues that an exemption under Rule 16b-3(d) is an "affirmative defense, which the defendants must plead and prove" and which he "is not obligated to refute." (Pl's. Opp'n Br. at 10, n.5.) The *Roth* Court rejected this same argument as a characterization of the law that is "anything but complete." *Roth II at* *6. Judge Breyer explained that the plaintiff conceded the effectiveness of the affirmative defense, since his same counsel "spilled most of his ink crafting allegations in an effort to render the SEC's exemptions inapplicable." *Id.* Consequently, the *Roth* Court held that the plaintiff's complaint had a "built-in defense" appearing on the face of his complaint and the defendant could "test the validity of the defense by a motion to dismiss." *Id.*, *quoting* 5 Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 1276, at 623-24 (3d ed.2004).

Plaintiff does not have *carte blanche* to bring unsupported claims and use his Complaint as a discovery tool; nor may Plaintiff shift the burden of substantiating his claims on Defendants.[4]

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[4] *See In re Stac Elec. Sec. Litig.*, 89 F.3d 1399, 1405 (9th Cir.1996) (holding Rule 9(b) serves "to deter the filing of complaints as a pretext for the discovery of unknown wrongs, to protect [defendants] from the harm that comes from being subject to fraud charges, and to prohibit

IV. PLAINTIFF'S OPPOSITION FAILS TO REFUTE THAT THE HOLDING EXEMPTION UNDER RULE 16B-3(D)(3) APPLIES

Plaintiff's Opposition correctly recognizes that an option grant to an insider "will be exempt from Section 16(b) liability so long as at least six months elapses between the acquisition and disposition of the shares acquired upon exercise of the derivative security." 17 C.F.R. §§ 240.16b-3(d)(3); *see Olagues v. Semel*, 2007 WL 2188105 *3 (N.D. Cal. Jan. 18, 2007) M. Jenkins. Since he cannot dispute that Mr. Bendush held the option grants in 2000 for more than six months, Plaintiff claims the exemption under Rule 16b-3(d)(3) does not apply because they were not board-approved "in accordance with the 'gate-keeping' criteria set forth in Rule 16b-3(d)(1) or (2)." (Pl's. Opp'n Br. at 12.) Contrary to Plaintiff's assertion, the exemption is "not dependent on board or committee approval." Stanley Keller, *Stock Option Pricing Practices Occupy Center Stage*, 1574 Practising Law Institute, PLI Order No. 12104 (Sept. 2006). Not only did Judge Breyer reject Plaintiff's very argument in *Roth,* even this Court essentially reached the same conclusion. *See Olagues, supra,* at *5 n.3 (because Rule 16b-3(d)(3) exemption applied, court did not need to address whether Rule 16b-3(d)(1) exemption was applicable); *see also Roth II* at *2 (no short-swing liability if grant meets one of three conditions under Section 16b-3(d)).[5] Indeed, the plain language of the Rule states an exemption is available under Rule 16b-3(d)(1) "or" Rule 16b-3(d)(3). (17 C.F.R. §§ 240.16b-(3)(1)-(3).) Once again, Plaintiff's theory should be rejected for the same straightforward reasons.

V. THE OPPOSITION DOES NOT REFUTE THAT PLAINTIFF'S CLAIM IS TIME-BARRED AND EQUITABLE TOLLING IS INAPPLICABLE

A. Plaintiff Cannot Plead Around The Statute Of Limitations By Incorporating A "Proper Disclosure" Condition That Is Unrecognized By Law

Having filed his action more than six years after the challenged grants, Plaintiff argues that the two-year statute of limitations is tolled due to "defendants' failure to make *proper* filings

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plaintiffs from unilaterally imposing upon the court, the parties and society enormous social and economic costs absent some factual basis.").

[5] The SEC is "persuaded that satisfaction of any of the three conditions is a sufficient basis to exempt an acquisition of issuer equity securities from the issuer." *Ownership Reports and Trading by Officers, Directors and Principal Security Holders,* 61 F.R. 30376, 30380 (final rule release June 14, 1996) (emphasis added).

with the SEC" that would have "put anyone on notice of a § 16(b) disgorgement claim." (Pl's. Opp'n Br. at 14) (emphasis added). Yet, the Section 16(a) forms at issue fulfill the necessary disclosure requirements.[6]

To support his theory, Plaintiff primarily relies on a pair of decisions from the Second and Ninth Circuits. However, in each case the courts held that the statute of limitations on the Section 16(b) claim was equitably tolled because the defendants failed to file timely disclosures altogether.[7] Under Plaintiff's recasting of the law, the two-year limitations period would be quickly rendered meaningless by any blanket allegation that a defendant's forms do not contain "proper disclosures." Not surprisingly, Plaintiff offers no authority for tolling where disclosure allegedly was made, but was not "proper." Plaintiff's overreaching theory should be rejected.[8]

B. Plaintiff's Tolling Theory Fails As Tolling Is Not Permitted When Section 16(a) Reports Were Filed

Plaintiff asserts that because he was not "on notice" that a "§ 16(b) disgorgement claim existed," there is "no basis to start the running of the limitations period." (Pl's. Opp'n Br. At 14.) The Ninth Circuit has already rejected this "notice" theory.

In *Whittaker v. Whittaker Corp.*, 639 F.2d 516, 528 (9th Cir. 1981), the Ninth Circuit considered three theories of how the two-year limitations period should be construed: (1) a "strict" theory of interpretation, where the period runs from the time the profits were realized and tolling does not apply; (2) the "notice" theory, where the period is tolled "until the Corporation had sufficient information to put it on notice of its potential § 16(b) claim;" and (3) the

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[6] Section 16(a) requires only a basic disclosure that "indicate[s] ownership by the filing person at the date of filing, any such changes in such ownership, and such purchases and sales of the security-based swap agreements as have occurred since the most recent such filing under such subparagraph." 15 U.S.C. § 78p(a)(3)(B).

[7] *See Whittaker v. Whittaker Corp.*, 639 F.2d 516, 528 (9th Cir. 1981) ("[T]olling of the two year time period is required when the pertinent Section 16(a) reports are *not filed*.") (emphasis added); *Litzler v. CC Investments, Ltd.*, 362 F.3d 203, 208 (2d Cir. 2004) ("[T]olling is triggered by noncompliance with the disclosure requirements of Section 16(a) through *failure to file* a Form 4.") (emphasis added).

[8] *See Conerly v. Westinghouse Electric Corp.*, 623 F.2d 117, 119 (9th Cir. 1980) (where the limitations period appears on the face of a complaint to have run, motions to dismiss should be granted if the plaintiff cannot prove statute is tolled under the allegations made).

"disclosure" theory, where the time period is "tolled until the insider discloses the transactions at issue in his mandatory § 16(a) reports." *Whittaker,* 639 F.2d at 527. The Ninth Circuit rejected the "notice" interpretation, finding that "the disclosure interpretation is the correct construction of § 16" and that tolling is "required when the pertinent Section 16(a) reports are not filed." *Whittaker,* 639 F.2d at 527, 528 (emphasis added). Since Plaintiff does not, and cannot, allege that Mr. Bendush did not actually file the requisite disclosures, Plaintiff's claim is time-barred and cannot be saved under a notice tolling theory.

C. Even If Plaintiff's Tolling Theory Was A Viable Option, Plaintiff's Claim Fails For Not Pleading Particularized Facts

Even setting aside the viability of Plaintiff's tolling theory, the Complaint does not state facts sufficient to justify tolling the statute of limitations. Plaintiff cannot identify any particularized factual allegations demonstrating that Mr. Bendush's designation of the three challenged transactions as exempt was actually fraudulent. In other words, Plaintiff's tolling argument fails because its underlying premise – that Rule 16b-3(d) exemptions do not apply – is not supported by particularized factual allegations. Accordingly, Plaintiff's claims against Mr. Bendush are time-barred.

VI. CONCLUSION

For the reasons set forth herein and in Mr. Bendush's opening brief, Mr. Bendush asks this Court to grant his Motion to Dismiss and dismiss Plaintiff's claim against him.

Dated: November 9, 2007

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Case No. C 07-2917 MJJ

CERTIFICATE OF SERVICE

I hereby certify that a copy of the following document(s):

- **REPLY IN SUPPORT OF MOTION TO DISMISS COMPLAINT FOR VIOLATION OF THE SECURITIES EXCHANGE ACT OF 1934 BY DEFENDANT WILLIAM E. BENDUSH**

were served upon all counsel of record via CM/ECF as indicated/listed on the United States District Court, Northern District of California's CM/ECF registered email list in the above-referenced matter (as set forth below):

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Executed this 9th day of November, 2007, at San Diego, California.

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